Portfolio Commentary

Navigator® MultiStrategy

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Coronavirus Pain: “Essential” Versus “Non-Essential”

Who could have predicted that the first quarter of 2020 would go down in the record books as the worst first quarter ever for the Dow and S&P 500? After all, on February 19th, the S&P 500 was up over 5% and the NASDAQ up over 11%. There were zero signs of economic trouble. Of course, that proved to be the market high, and the coronavirus pandemic was already spreading from China and across the globe. China and parts of Asia, then Italy and Iran, and finally the U.S. and the rest of the world were swept up in the pandemic. First, international flights were banned by region and weeks later, governors across the United States were putting their entire states on lockdowns.

Only a month later, by March 23rd, markets had crashed in a fashion similar to 1987 and 1929. The S&P 500 fell by 33.8%, and small-caps declined by 39.6%. After a relief rally to end the quarter, the S&P 500 ended the quarter down 19.6%, with small-caps down 32.6% and energy stocks losing more than half their value. Investor sentiment collapsed and we saw the largest four-week move in bearish sentiment in the market's history – more so than in 2008. It took only 18 days to fall into a bear market – the fastest time ever. Credit markets, including investment grade and high yield bonds, endured their worst periods since 2008. Only U.S. Treasuries and cash proved to be safe havens.

It is one thing for a recession to slow economic growth by a few percentage points, but this pandemic has caused many travel-related and “non-essential” businesses to come to a sudden stop. During the decline, “essential” businesses in sectors like Household Goods, Healthcare, and Utilities served as safe havens, along with businesses that thrive online like Technology and Communication Services. Credit markets were hit very hard as well, with investment grade and high yield bonds hit the hardest since 2008. Investment grade bonds fell by over 3% and high yield bonds declined 12%.

Amidst such a turbulent and painful market environment for investors, how did our MultiStrategy portfolios fare? We believe our relative strength models helped us to avoid the greatest areas of pain within stocks (small-cap, mid-cap, and value stocks), and more importantly, helped us de-risk the fixed income portion of the portfolio out of high yield during the quarter. As the quarter came to end, however, we re-entered high yield bonds. While the position exposes us to credit risk in this uncertain environment, we re-entered at lower prices and believe that our model remains vigilant, and we are ready to quickly de-risk the portfolio upon further market weakness.

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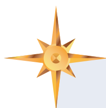

U.S. Equity— Avoiding the Traps

The U.S. equity portion of the MultiStrategy portfolios ranks U.S. equity styles and factors using Clark Capital's Relative Strength-based ranking methodology, and then purchases those ETFs with higher rankings (and avoids those with lower rankings), creating a broad-based portfolio that attempts to outperform the S&P 500.

The equity portion of MultiStrategy entered 2020 with a modest focus on value stocks (SPYV) and buybacks (PKW), but in early January, we put on a major shift into large-cap growth (SPYG), quality (QUAL), and the S&P 500 Index itself (IVV). By February 19th, which turned out to be the top, we added momentum (MTUM) to the mix.

Large-cap growth and momentum were the market leaders coming into the top, and that continued during the decline. In fact, the momentum ETF's relative performance accelerated during the decline, as it had an overweight to Utilities, Consumer Staples, and Technology. Our research on our own methodology tells us that as markets bottom, momentum and relative strength enter the period when they are most likely to underperform and when a major bottom takes place, new leadership (often the prior losers) begins to outperform. As a result, we sold our position in momentum and only own a large position in the S&P 500 and large-cap growth. In doing so, we are, to a certain extent, looking through the ongoing bottoming process and preparing to fully participate in market gains once a bottom sets in. We wish to avoid the traps of being too defensive at the market bottom.

When speaking of our methodology, the focus is naturally on what we have owned for clients. However, an essential element of relative strength that goes unstated is what the portfolio doesn't own, which we believe is equally as important. Through the worst of the decline, the portfolio avoided mid-caps, small-caps, and value stocks. The table below show how much each equity style lost during the entire quarter and during the entire downturn:

Index or ETF Name	1st Quarter 2020	Bear Market Decline (2/19 to 3/23)
S&P 500 Index	-19.6%	-33.8%
S&P 600 Small Cap Index	-32.6%	-41.2%
S&P 500 Large Cap Value ETF (SPYV)	-25.2%	-36.7%
S&P 500 Large Cap Growth ETF (SPYG)	-14.4%	-31.3%
Small Cap Value ETF (IJS)	-37.5%	-43.3%
Small Cap Growth ETF (IJT)	-28.5%	-41.2%

Source: Bloomberg

Most investors would not expect large-caps and large-cap growth stocks to lead markets for as long as and with as much magnitude that they have and then also be leaders during a decline. Our focus on large-caps in general, the S&P 500 Index, and large-cap growth in particular, helped us reduce client losses and avoid the carnage seen in small-caps and particularly in small-cap value. Moreover, on the other side of this ongoing bottoming process, we see the potential for outsized gains in small-caps and value stocks, which are now priced at their cheapest levels in years. However, until their trends stabilize and they show relative strength, we are forced to wait for a recovery to begin and establish itself.

Fixed Income—Actively De-Risking

The fixed income portion of MultiStrategy portfolios engages in segment rotation within fixed income, owning high yield bonds, Treasuries, or cash, whichever our models determine has recent relative trends in its favor. The fixed income segment of MultiStrategy was very active in the credit markets, de-risking the portfolio out of high yield as the downturn progressed, and eventually, near the end of March, the strategy re-entered high yield at lower prices and higher yields.

High yield bonds began the year on the rise and were up over 1% as the market peaked on February 19th. Our credit-risk management model, however, peaked in mid-January, and perhaps the strength in Treasuries was reflecting the beginning of the coronavirus crisis in China. It is impossible to know, but Treasuries began to strengthen before the market peaked. As a result, when the markets peaked and credit markets turned on February 26th, only a week after the top, we reduced our high yield position in half and purchased Treasuries with half the portfolio.

Lower quality credit markets continued to deteriorate, and by March 9th , we exited high yield entirely. Between February 26th and March 9th, the Treasuries we owned with half of the portfolio were up about 4% while the high yield bonds we owned in the other half declined by 5%. While the portfolio had small losses during that period, it was much less than owning only high yield. After our March 9th exit from high yield, markets, and particularly high yield bonds, collapsed. Between March 9th and the market bottom on March 23rd, the High Yield Bond Index collapsed by 15.6% in just two weeks.

As the Federal Reserve stepped in and provided a support facility for many companies, particularly investment grade companies, markets rallied sharply off the March bottom. Only four days later, we bought back into high yield bonds, which we currently own as the quarter ends. We engaged in

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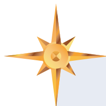

a lot of trading within the credit markets during the quarter, and that activity is summarized below in terms of the average price of the bonds in the S&P 500 High Yield Bond Index:

January 17th	Average high yield bond price peaked at 102.49
February 26th	Sold half of our high yield bond position and bought Treasuries; average price at 101.28.
March 9th	Sold other half of our high yield position; average price at 95.56.
March 23rd	Markets bottomed; average price at 80.05.
March 27th	Re-entered high yield bonds when average price was at 85.29.

Source: Bloomberg

In the fixed income portion of MultiStrategy, we are focused on mitigating risk and avoiding substantial loss. While owning high yield bonds may seem risky in the middle of today's turmoil, the dynamic nature of the strategy allows us to be tactical and shift to safer asset classes when directed by the quantitative models which drive the strategy. In the longer run, however, we believe there is significant return potential in the high yield asset class. High yield spreads over government bonds exceeded 10% during the decline, and on average, when that has occurred, returns are five-to-six times above average for the next six months. While we wait for a bottom to form, we are confident regarding the losses that we were able to minimize and are excited for the potential for future gains.

Conclusion

We live in times of unprecedented uncertainty and disruption. Is the coronavirus bringing well over half of the economy to a dramatic slowdown a short-term halt or more intermediate-term phenomenon?

History tells us that despite the uncertainty, we should fear becoming too defensive. Since World War II, in the quarter after a 15% decline in the S&P 500, only once has the index followed up that quarter with another decline. Moreover, returns over the next two years are two times the historical average. The Federal Reserve and U.S. government have taken quick action to provide a cushion of support the economy and lending markets – much more quickly and with more magnitude than in 2008. The Fed created a facility that can purchase and support the investment grade bond market, greatly reducing the fat tail of a large decline in that segment. Credit markets may present opportunities, as 15% of BBB Investment Grade Bonds are trading at yields below BB- junk bonds.

Their bad news has been priced in, and any relief from that bad news – not necessarily even good news – could spark a price rally. We believe to be sure, there will be volatility ahead, including news of economic recession, corporate bond downgrades from investment grade to junk, and high unemployment.

We believe our equity models are keeping us in higher quality large-caps as we do not see sustained trends in potentially higher returning but risky mid and small-caps. We will not pursue riskier equities until they show stronger signs of recovery.

Our credit models that we run daily favor risk-on in high yield at the moment, but we are prepared to reverse course if weakness reasserts itself. We may be in an out of high yield once more before a final bottom is found. An economic turnaround from this pandemic we believe will likely take years. We would not expect corporate earnings to exceed 2019's fourth quarter until at least 2021, and a return to 4% unemployment will likely take longer.

However, as markets and the economy return to running under more normal circumstances, we believe there is great potential for the "non-essential" industries that are beaten down to provide strong returns in the future. We are watching closely if positive trends in credit continue, always focused on avoiding large losses in credit and underperformers among equities if at all possible.

Ticker	Quarter Ending March 31, 2020	Average Weight (%)	Contribution to Return (%)
Top Contributors MultiStrategy 25-75			
QUAL	iShares Edge MSCI USA Quality Factor ETF	3.93	0.26
SPYV	SPDR Portfolio S&P 500 Value ETF	0.93	-0.06
PKW	Invesco Buyback Achievers ETF	0.74	0.03

Ticker	Quarter Ending March 31, 2020	Average Weight (%)	Contribution to Return (%)
Top Detractors MultiStrategy 25-75			
NTBIX	Navigator Tactical Fixed Income Fund Class I	72.90	-2.96
IVV	iShares Core S&P 500 ETF	10.40	-2.36
SPYG	SPDR Portfolio S&P 500 Growth ETF	7.89	-1.64

Source: Factset. For illustrative purposes only. Past performance does not guarantee future results. The holdings identified do not represent all of the securities purchased, sold or recommended for advisory clients. In the chart above, "weight" is the average percentage weight of the holding during the period, and "contribution" is the contribution to overall performance during the period. To obtain the calculation methodology and a list showing every holding's contribution to the overall composite during the period, contact: PortfolioAnalytics@ccmg.com.

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Ticker	Quarter Ending March 31, 2020	Average Weight (%)	Contribution to Return (%)
Top Contributors MultiStrategy 50-50			
QUAL	iShares Edge MSCI USA Quality Factor ETF	7.84	0.50
SPYV	SPDR Portfolio S&P 500 Value ETF	1.78	-0.12
PKW	Invesco Buyback Achievers ETF	1.23	0.06

Ticker	Quarter Ending March 31, 2020	Average Weight (%)	Contribution to Return (%)
Top Detractors MultiStrategy 50-50			
IVV	iShares Core S&P 500 ETF	20.95	-4.74
SPYG	SPDR Portfolio S&P 500 Growth ETF	16.03	-3.34
NTBIX	Navigator Tactical Fixed Income Fund Class I	47.85	-1.97

Ticker	Quarter Ending March 31, 2020	Average Weight (%)	Contribution to Return (%)
Top Contributors MultiStrategy 75-25			
QUAL	iShares Edge MSCI USA Quality Factor ETF	11.40	0.70
SPYV	SPDR Portfolio S&P 500 Value ETF	2.54	-0.16
PKW	Invesco Buyback Achievers ETF	1.72	0.07

Ticker	Quarter Ending March 31, 2020	Average Weight (%)	Contribution to Return (%)
Top Detractors MultiStrategy 75-25			
IVV	iShares Core S&P 500 ETF	33.72	-7.57
SPYG	SPDR Portfolio S&P 500 Growth ETF	22.63	-4.96
MTUM	iShares Edge MSCI USA Momentum Factor ETF	2.99	-1.52

Source: Factset. For illustrative purposes only. Past performance does not guarantee future results. The holdings identified do not represent all of the securities purchased, sold or recommended for advisory clients. In the chart above, "weight" is the average percentage weight of the holding during the period, and "contribution" is the contribution to overall performance during the period. To obtain the calculation methodology and a list showing every holding's contribution to the overall composite during the period, contact: PortfolioAnalytics@ccmg.com.

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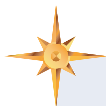

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The volatility (beta) of a client's portfolio may be greater or less than its respective benchmark. It is not possible to invest in these indices.

Index returns include the reinvestment of income and dividends. The returns for these unmanaged indexes do not include any transaction costs, management fees or other costs. It is not possible to make an investment directly in any index.

The most widely used indicator of the overall condition of the stock market, the Dow Jones Industrial Average Index is a price-weighted average of 30 actively traded blue chip stocks as selected by the editors of the Wall Street Journal.

The S&P 500 measures the performance of the 500 leading companies in

leading industries of the U.S. economy, capturing 75% of U.S. equities.

The NASDAQ Composite is a stock market index of the common stocks and similar securities listed on the Nasdaq stock market.

High Yield Corporate Bond Index is designed to track the performance of U.S. dollar-denominated, high-yield corporate bonds issued by companies whose country of risk use official G-10 currencies, excluding those countries that are members of the United Nations Eastern European Group (EEG).

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